The Market in Review

Paul Siluch, Lisa Hill, Peter Mazzoni, and Sharon Mitchell
Financial Advisors
Raymond James Ltd. – Victoria BC

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This week's articles and insights

"Turn a situation or problem upside down. Look at it backward.

"What happens if all our plans go wrong? Where don't we want to go, and how do you get there?

"Instead of looking for success, make a list of how to fail instead – through sloth, envy, resentment, self-pity, entitlement, all the mental habits of self-defeat. Avoid these qualities and you will succeed.

"Tell me where I'm going to die, that is, so I don't go there."

– Charlie Munger, Warren Buffet's partner

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	25,463	+ 0.04%	+ 3.01%
S&P 500	2,840	+ 0.76%	+ 6.24% (+ 9.69% in $CDN)
TSX	16,420	+ 0.16%	+ 1.30%

From the Eternal to the Ephemeral

We just returned from the city of Ravenna, Italy, where we travelled to see the mosaics that date back to the year 547 AD. These were Byzantine churches – the eastern half of the Roman Empire that survived – built in the era of Justinian. They were meant to be eternal monuments to God and were built to last - the primary material of a Byzantine mosaic is glass, which is a material that weathers well and never loses its lustrous colour. The art of huge mosaics reached its zenith around 550 AD, then was lost when Ravenna fell to the Lombard's in 750. The fact that they have survived in all their glory for 1,500 years is testament to the enduring craftsmanship of the Byzantine Christians.

Our culture today is far more temporary - from the eternal to the ephemeral, I call it. Music and fashions change rapidly and technological gadgets we adore today are obsolete tomorrow. Recon Analytics says the average age of a smartphone in the US is just 21 months. Manufacturers bring out new features so quickly we, the public, line up to buy every new model the moment it is released.

What else is fading?

1. Cash.

In 2011, the San Francisco Federal Reserve reported that 4 in 10 purchases under $10 were done using cash. By 2016, this was down to 3 in 10. Today, some businesses don't even take cash at all. An article by Henry Grabar in Slate magazine reports Starbucks's (**NASDAQ SBUX**) is experimenting with a cashless store. Electronic payments are even more widespread in China, where the vast majority of small purchases are now made with plastic or right from your phone.

It used to be that the 4% charge credit card companies take on each purchase was a hard pill to swallow for most merchants. Today, “the various hassles of dealing with cash—employee training, banking fees, armored-truck pickups, and the occasional robbery—outweigh the cost of credit card fees,” writes Grabar.

This shift is profoundly positive for the credit card companies, like Visa (**NYSE V** – owned in our Dividend Value portfolios), as well as the many new payment vendors, such as Apple Pay and Square (**NASDAQ SQ**).

2. The allure of gold is fading.

At least, it has become less popular. The rise of bitcoin and electronic payments has bitten into the golden apple, sending the price down to US $1,225 from $1,350 just a few months ago. Speculative short positions (i.e. traders) are the largest since 1993, which tells us they think it will fall further. Vanguard recently announced they are renaming their Vanguard Precious Metals and Mining Fund to Vanguard Global Capital Cycles Fund. Both of these anecdotes suggest pessimism is excessively high for gold.

We have seen this before. Gold has been a monetary asset for 5,000 years, which is something that is unlikely to change. Gold normally tracks the US money supply closely, but this link has decoupled in recent years. With inflation bubbling and many existing gold mines depleting, don’t be surprised if gold surprises in the years ahead.

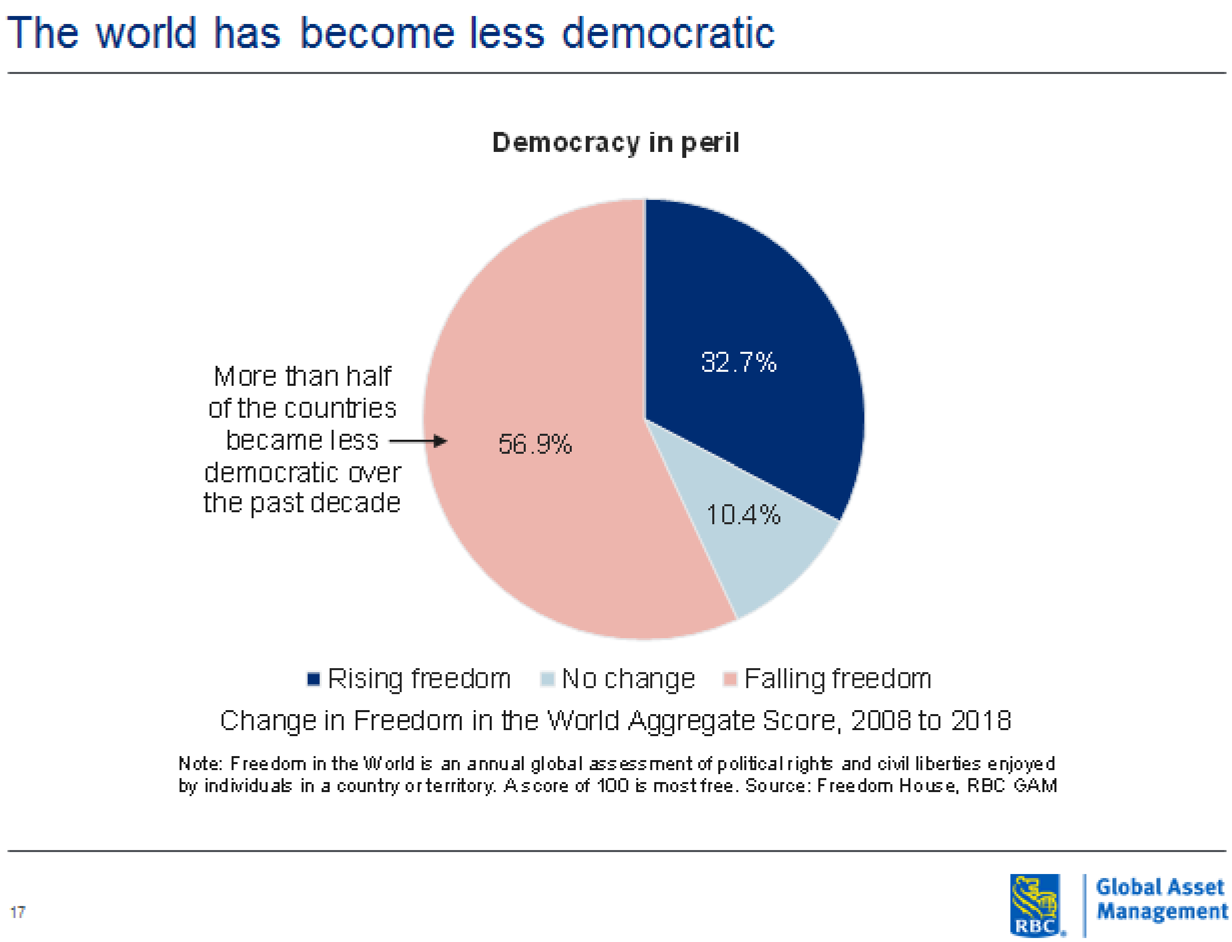
3. Small countries are fading.

Ivan Krastev of the Financial Post reports that 11 countries have shrunk by more than 10% in terms of their population size since 1989. We first discovered this in Croatia last year, where a cab driver lamented that 100,000 of Croatia’s young had departed for better jobs in places like Germany. “Latvia lost over a quarter of its population (27%), Lithuania 23%, Bulgaria and Bosnia and Herzegovina 21%. For instance, the Bulgarian population contracted from 9 million in 1989 to 7.1 million in 2017.” Romania and Ukraine have also been shrinking each year.

Cities grow and countries shrink. Welcome to the new world.

4. Democracy is waning.

Almost twice as many countries in the world experienced fewer democratic conditions than more in the last decade, according to Freedom House. Not a surprise, when you read the papers. Not what you want to see, either.



Markets This Week - July Done, August Ahead

We are now well into the summer doldrums. July is normally a good month – the best month of the 3rd quarter – and it certainly was this year. The S&P 500 returned approximately +3.72%, which is well above its July average of +1.0% since 1950 (source: Stock Trader's Almanac). Canada's S&P/TSX rose +1.15%.

Up until this month, it has been a wobbly year so far, though. July just helped us catch-up after six weak months since January.

Next up is August. Where July ranks 6th in terms of monthly performance for the year, August is typically 10th. This is followed by the worst month of the year, September, at the 12th and final spot.

They say the market does best when it has a “wall of worry” to climb. This means investors are nervous and are holding cash instead of being fully invested. There is certainly a steep “wall of worry” this year. Let’s have a look at the bricks in this perilous wall.

First, the multi-year, multi-trillion dollar stimulus programs begun in 2008 continue to wind down. Both the US and the European Union are removing excess cash from the system, with the US removing $40 billion per month. The US is also raising interest rates, as is Canada. As long as the global economy is expanding, this is tolerable. But, if conditions weaken, rising interest rates could make things worse. We are already seeing real estate sales soften all over the globe due to housing restrictions (as we have here in B.C.) and rising mortgage rates.

Second, the tariff wars. July witnessed new hope that the US and the EU were tip-toeing toward some sort of tariff reductions. There were even rumours of backdoor talks between Chinese and US trade officials on Tuesday, only to see all hope dashed Wednesday when President Trump suggested he would up the next $200 billion in Chinese tariffs to 25% rather than the initial 10% first announced. Of course, China is threatening to retaliate. The perception has been, so far, that China has far more to lose in a trade war with the US. They should be willing to back down sometime soon, right?

China is a powerful nation, though, and it plays the long game. It may be willing to suffer economically until President Trump is gone or hobbled by his behaviour.

As we stated in our last letter, the US goal is a tariff-free world. Will these crude threats bring this about? No one seems to think so, but the talks with Europe may be the first sign they are.

And third, the Chinese economy is weakening. The country carries even more debt than the US does, and the US tariffs are starting to bite. While both

Canadian and US markets are positive for the year, the main Chinese index is down almost 15%.

When there is a great deal of pessimism, markets often rise rather than fall. What is happening that contradicts the wall of worry?

Economic growth here at home. In Canada, the May numbers were very strong - the most widespread economic growth in 14 years. In the US, an ADP survey showed companies added 219,000 new jobs. This was the strongest since February.

Growth is resilient, in other words. Employment is rising and so are wages.

For markets, 2018 has been a tug-of-war between unmannerly politics and trade wars on one side, and scorching economic growth on the other. So far, the growth side is winning, but the weakest period of the year looms ahead.

We expect August and September to be noisy and volatile, but not portfolio-threatening.

Stay tuned…

Thank you for your referrals this month! They are always handled with great care and discretion.

Charting the Departing's Assets

The accounting firm Deloitte has found that the average Canadian will have $10,000 in digital assets by the year 2020.

What is a digital asset? Think files, photos, blogs – "virtual properties" – as well as digital currencies, such as PayPal accounts. Then add in reward points and licenses to songs purchased at sites such as iTunes.

CI Financial's estate planning team has done some interesting research on this new realm of personal wealth. It is important because a recent BMO study showed that 57% of Canadians have no provisions in their wills to take these assets into account. They should. In some cases, executors and beneficiaries cannot access these assets, or even cherished photos, once the owner has died.

"Digital assets such as e-mails, photos and messages often hold sentimental value. The tweets of a deceased loved one are the 21st century's version of a personal journal or diary. An iTunes library is the modern-day record collection and Facebook pictures are virtual photo albums. With digital property replacing physical property, it is vital that such property is accounted for in an estate plan."

They list these steps to plan for digital assets in a will:

1. Identify: Create an inventory of all digital assets and update it on a regular basis.
2. Appoint: Appoint a trustee who is specifically authorized to manage the client's digital accounts. This can be the executor/ liquidator or a separate trustee who is solely responsible for managing the digital assets. Remember, a good estate plan does not only consist of a will, but also includes powers of attorney for personal and financial care, or a protection mandate in Quebec.
3. Access: Ensure a password-protected list of digital assets is accessible to the trustee.
4. Instruct: Include detailed instructions in their estate plan. These instructions notify trustees as to how the client would like their assets to be distributed amongst heirs.

We have attached the article to the letter this week. It is certainly worth discussing with your lawyer the next time you renew your will.

http://www.raymondjames.ca/siluchhill/

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How to contact us:

paul.siluch@raymondjames.ca
lisa.hill@raymondjames.ca
peter.mazzoni@raymondjames.ca

(250) 405-2417

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Prices shown are as of close August 3rd, 2018.

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